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FINANCIAL ASPECTS OF THE TRUST PROBLEM.

INTRODUCTION.

Before 1883, when the Standard Oil Trust was formally organized, manufacturing combinations were almost unknown, nor did they begin to attract much notice until after the organization of the American Sugar Refining Company, in 1887. Even then, in spite of the popular outcry against monopoly, and the anti-trust laws which were enacted by national and state legislatures, only twenty combinations of any importance were listed on the New York Stock Exchange up to 1893, when the panic brought the incipient movement toward consolidation to a sudden end. The real trust movement dates from 1898. Two years have sufficed to reorganize the manufacturing industries of the United States, in whole or in part, along lines of consolidation. The "United States Investor" gives a list of 565 combinations organized within the last two years, with a capitalization of more than seven billions of dollars.¹ During the first six months of 1899, one hundred and two consolida-

¹ "United States Investor." December 30, 1899.

tions with a capitalization of three billions, were organized and floated.¹ The universality and spontaneity of this movement raise the question of its origin and cause. It is proposed in this paper to examine the trust from the standpoint of speculation and investment.

The Trust movement began with the close of the industrial depression which followed the panic of 1893 and which, as a matter of origin, can be traced to the Baring panic of 1890. The steady fall of prices and the slow-moving liquidation of credit during this period had severely handled the manufacturers and traders of the United States. The aggregate liabilities of failures in manufacturing and trading from 1894 to 1898 exceeded seven hundred and fifty millions of dollars. Few business men made large profits. Almost everyone had his scale of earnings greatly reduced. Many of those who did not fail outright staggered under heavy burdens of debt, and falling prices, and saw their plants deteriorate for lack of the money to keep them in good repair. General business was dull and stagnant. New York clearings decreased eight billions of dollars from 1892 to 1895. The financial world was even more depressed. An index number made up from the prices of ten leading railroad stocks shows a decline from 1892 to 1896 of 31 per cent. Sales of stocks on the New York Exchange, during the same period, decreased thirty-one millions of shares. New issues of stock listed from 1894 to 1896, compared with the three years preceding, decreased one hundred and fifty-six millions of dollars. The surplus cash of the country flowed into the New York banks, and from 1893 to 1897, their surplus reserve available for loans seldom fell below twenty millions of dollars. The rate on call loans during the same time seldom rose above one per cent. But easy money was powerless to excite much speculation. The people were busy with debt-paying. They had realized the penalties of overconfidence and they were in no humor for risk-taking. In

¹"Commercial and Financial Chronicle," vol. 69, p. 55.

the retrospect of 1895 the "Financial Review" remarked on the situation as follows: "The result of these hard times has been to make our own investors unusually cautious and to produce extreme wariness of American securities, on the part of foreign capital. Under such conditions it could not be expected that the listings of stocks and bonds representing *new* enterprises would be heavy."¹

With the summer of 1897, recovery began. A large wheat crop, sold at good prices, increased the earnings of the grain-carrying railroads and stimulated investment in their securities. From 1896 to 1897, the earnings of the five "granger" roads running into Chicago increased \$14,677,000. The effect of increased earnings was soon felt in the stock market. During 1897, the prices of these granger stocks increased as follows; the first quotation being the lowest price in January and the second, the highest price realized during the year:

Atchison, Topeka and Santa Fe (preferred)	22½ to 35½
Chicago, Burlington and Quincy	69¾ to 100¾
Chicago, Milwaukee and St. Paul	72¾ to 102
Chicago and Northwestern	102¼ to 132½
Chicago, Rock Island and Pacific	65½ to 92½

Other railroad stocks advanced in sympathy with the grangers, the increase being as much as twenty points in the case of several roads and reaching 29½ in Northern Pacific preferred. Under the stimulus of higher prices the sales of stocks on the New York Exchange increased in one year twenty-two million shares. The buying, however, was as yet almost wholly confined to old securities. Large amounts of low priced reorganization securities were coming into the market, and the tempting bargains which these offered occupied the attention of investors, while the rapid rise in all railroad stocks furnished abundant opportunity for speculation.

The industrial revival gathered strength in 1898; another

¹ "Financial Review," 1890, p. 15.

large harvest and continued high prices increased granger earnings \$17,753,000 over the high figures of 1897 and their stocks continued to lift the entire market. Other industries increased their output. From 1897 to 1898 the production of pig iron increased 1,121,000 tons. Foreign trade was also favorable. During this year, exports of merchandise exceeded imports by six hundred and twenty-three millions of dollars, and an importation of \$141,000,000 of gold strengthened the basis of American credit. General business was stimulated by these favorable circumstances. From 1896 to 1898, New York clearings increased thirteen billions of dollars. The rapid improvement of business united with the successful result of the Spanish War to inspire in all classes the most sanguine optimism. The people believed that good times and high prices had come to stay. The first buying of stocks came from the investors, who were attracted by the larger earnings of railroads to transfer their capital to more promising investments. A speculative demand for these securities set in at the same time. Large amounts were bought to sell at an advance. The large profits which were rapidly realized attracted general notice and the demand for stocks became general. The stock market was the place where money was to be made. People of every class and condition caught the fever of speculation and were ready to buy. It was impossible to supply this demand for stocks from existing issues. Most of these were held for investment and only small quantities came into the market. The time was ripe for the promotion of new enterprises. New schemes were organized and their securities were readily sold.

This condition called the "promoter" to the front. It is the promoter who organizes new companies and places their prospects before the speculative and investing public. His organizing energy usually, although not of necessity, follows the line of largest immediate advantage to the community. Is there a demand for new industries, or new

combinations of industries?—the promoter recognizes this fact, organizes companies, and supplies the demand. Taking advantage of the most promising outlets for industrial activity, he capitalizes the new opportunities and markets the securities while the public is in the humor for buying shares. If we go back to the early years of our industrial history, we find him organizing banking and land companies. At a later period railroad schemes were put on the market. Public service corporations, mines, and street railways have each had their share of attention. Whenever an opportunity is presented for the exploitation of new resources, or new conditions, the promoter is on hand with his prospectuses and his propositions “to be submitted to the approval of the investing public.”

Railroads had furnished the bulk of the new securities since the Civil War, but in 1898 railroads were no longer available. The country had been well equipped with transportation facilities and few prospects for new mileage were put forward. From 1886 to 1889 28,545 miles of railroad were constructed, from 1896 to 1899 only 3,642 miles. From 1886 to 1889 \$1,421,800,000 of railroad securities were placed on the market. From 1896 to 1899, however, we have had an increase of only \$481,900,000 of railway stocks and bonds; most of them, moreover, being investment securities and selling at high prices. The former outlet for investment had been closed and a new one was now to be opened. This outlet was furnished by the organization of the industrials. Says the “Financial Review” of 1900 in its retrospect of 1899: “The extreme industrial activity engendered a feeling of great confidence, very propitious to the creation and multiplication of new industrial enterprises. Easy money in the early months, caused by a congestion of currency at this centre, materially aided the movement. The result was the formation and flotation of industrial undertakings of enormous magnitude and in unparalleled numbers. In every industry, in every line and branch of

trade, great consolidations and amalgamations were planned and in most cases carried into effect. It was the great opportunity of the promoter and he was not slow to avail himself of it. Seeing in any given trade a large number of separate businesses or manufactories, his effort was to merge them together in one large corporation, ensuring partial or complete control, and giving at least the appearance of monopoly."¹

The financiering of these industrial combinations it is now proposed to examine. I shall discuss (1) the inducements offered by the promoter to the firm owners; (2) the process by which the separate plants are purchased; (3) the profits of the promoter; (4) trust securities and the stock market; (5) the reasons for the collapse of the common stock, and (6) the financial outlook for the new organizations.

I. The principal inducements offered by the promoter to the firm owner are (a) the economy of combination and (b) the bonus in cash or stock. I shall discuss these in the order of their importance.

(a) *The economics of combination.*—The great distances which separate the centres of population in the United States, and the high transportation cost of supplying distant markets, have brought about a grouping of the chief manufacturing industries near the principal markets upon which they depend. Especially does this come about where the product is heavy and bulky and of a low value in proportion to its weight. This applies to most of the raw materials and half-manufactured products—the lines of manufacture, that is to say, in which most of the new combinations have been formed. The location of supplies of raw material is also a determining factor in the grouping of industries. The best illustration of this principle of the dispersion of industry is offered by the location of the plants of the iron and steel industry.

The grouping of plants about particular centres is fa-

¹ "Financial Review," 1900.

miliar. One group is located in New England, another in Eastern Pennsylvania, another in the Pittsburg-Cleveland district, a fourth about Chicago, a fifth about St. Louis and a sixth about Birmingham. Colorado and California have also developed iron and steel industries of some importance. In the Pittsburg-Cleveland, Chicago and Birmingham districts are to be found plants representative of the leading branches of the industry—blast furnaces, steel plants, rolling mills, wire and rod mills, bridge works, tin plate mills, and in general all the manufacturing industries which get their raw materials from the iron and steel industry. The subsidiary industries of the Pittsburg-Cleveland district are especially numerous, but it is only a question of a short time before Chicago and Birmingham will develop the branches in which they are now inferior to the East. Colorado is also rapidly developing a complete equipment for the manufacture of all kinds of iron and steel goods. Worcester, Philadelphia, St. Louis and San Francisco, on the other hand, buy their raw material in the form of pig-iron and steel billets from the centres where ore can be most profitably reduced and manufacture it into the finished form, gaining thereby an advantage in their local market over their competitors, who can indeed purchase their raw material more cheaply, but are handicapped by the higher charges on more highly finished products. Other industries follow in their location the same principle. The points of largest advantage are those which lie nearest the desired market, and the industrial centres are, therefore, widely separated one from the other. If supplies of raw material are also easily available, such a location becomes of pre-eminent value. Proximity to the market, however, other things being equal, is, in most cases, the deciding factor in the location of manufacturing plants. We see this illustrated in the western movement of the boot and shoe industry, which brings the manufacturer nearer his western market, and at the same time closer to his raw materials. We

see it also in the location of the sugar refining industry, which, though drawing its chief supply from abroad, has distributed its plants along the Atlantic seaboard, as near as possible to the various markets, and has also located plants at New Orleans, St. Louis, and San Francisco in order to get as close as possible to the market and to reduce to the lowest point the charges of transportation. We have then a division of the country into industrial centres, or groups of plants which correspond to centres of population and supplies of raw material.

Within each industrial centre is usually found more than one plant representative of each industry; and between these rivals there springs up an intense competition which, unless previously settled by some combination agreement, results in the victory of the strongest and best equipped. The losers in the contest are either crowded out altogether, or take up with some patented specialty. This rule applies particularly to industries like that of iron and steel production where large capitalization means cheap production. In the textile industries, where large capital is not so important, the process of consolidation is longer delayed, although even here a few large plants in every district are coming to monopolize the field, and it is only a question of time before these plants will decrease in number and increase in size by extermination of the weaker or by consolidation.

In the iron and steel industry, however, where more trusts have been organized than in any other—this movement toward consolidation has gone rapidly forward, and has already resulted in the concentration of production in the hands of a few large firms or corporations with a fair prospect that the weaker of these must either effect a combination with the stronger competitors or be exterminated. There are steel plants at Youngstown, Cleveland and Wheeling which have managed to thrive and grow in the immediate neighborhood of the Carnegie Works at Pittsburg. This development of outside plants has been largely by suffrance of the Carnegie

Company, which has had all the business it could handle without making a fight for the trade of its neighbors. It is only a question of time, however, before the Carnegie Company, owning its own mines, boats, railroads and coal fields, and equipped with the finest plant in the world, will come into conflict with its neighbors, and unless they can gain similar advantages, which is not likely, or unless they can effect some combination with the Carnegie Company, will drive them entirely out of the lines which it wishes to control. The outcome of this competition within industrial centres is the survival of a few strong firms, possibly it is not extravagant to say, of one strong firm in each branch of industry. It is of course conceivable that the process of concentration should go so far as to locate the steel industry of the entire country at Pittsburg, and to concentrate other lines of production in the same way, each at the point most favorably situated, but present indications and past experience do not point to this result. There is a limit to the economical increase of capitalization within a single plant, a limit reached long before the capacity of supplying the entire market is attained, and there is also the factor of transportation charges, which becomes more important as all plants are tending to greater equality of advantage, and which every improvement in transportation, discriminating as it does against the more valuable finished product and in favor of the more bulky raw material, only serves to emphasize. It seems likely that the dispersion of all manufacturing industries according to the location of markets is the ultimate goal of industrial development. The manufacture of tobacco, of meat products and of cotton goods has followed the lead of the iron and steel industry, and has been rapidly dispersed over new markets within recent years. There is little reason to expect a reversal of the process in the case of those industries whose location already conforms to widely sundered markets.

Within each group, therefore, when local competition is

eliminated, there tends to be a qualified monopoly, checked and controlled, however, by the competition of other centres. In the iron and steel industry Colorado and Birmingham are so far distant from competing centres of industry that the restraints of inter-group competition are not much felt ; but all other centres are near enough to each other to be influenced by the prices of the nearest competitors. Given equal equipment and facilities for production, each centre will control the prices in its immediate market, providing that it does not raise them to such a point as to more than equal the differential advantage which its location gives. This, however, is an important restriction, and so long as competition between centres prevails, serves to hold prices the country over to a competition level. The monopoly power of location is tempered by inequalities of advantage—the Carnegie Company, for example, influencing the entire country—and shades off toward neutral territory until at all points economically equidistant from each other, perfect competition prevails. Free competition, therefore, if allowed to work out to its ultimate conclusion, results in control of particular markets by particular firms for the larger part of the sales made in that market, and in a near approach to competitive prices in all markets where outside selling is to be feared by local producers.

This competition, whatever the public may think of it, is irksome to manufacturers. They are subject almost everywhere to a double inconvenience. They are fighting the local battle to its finish, often with much loss and trouble to all concerned, and even when this process of local centralization is accomplished, the control of the local market to which the successful have looked forward is restricted by the fear of outside competition to follow any attempt to raise prices more than a little above the competitive level. Moreover, they are driven on by fear of their competitors to make large expenditures upon betterments, to keep their plants up to the very highest standard of efficiency, and to

enlarge their capacity and lower their prices in order to control the market which is always slipping from their grasp. This policy of rapid improvement and large capital expenditure is no doubt for the advantage of the manufacturer under the given conditions and it results in remarkable improvements and discoveries from which the public gains an advantage in lower prices. But whatever its social effects, the manufacturer is not satisfied with its financial results. Such a policy is very hard on dividends. A high rate of dividend is practically impossible, and the payment of any dividend is dependent on the accumulation of a heavy surplus investment. Especially is the lot of the competitive manufacturers hard in times of depression. Then their only safe course is to improve and construct, to put practically all their earnings into betterments, and to trust to improving business to pay them. From 1892 to 1898 the Illinois Steel Company paid only one dividend while it nearly doubled the capacity of its plants. A moderate success under these circumstances is only to be attained by constant watchfulness and strenuous endeavor. It is true that success has been achieved in spite of competition. The constituent companies of the American Tin Plate Company, according to Mr. Griffiths' testimony before the Industrial Commission, made 20 per cent the year before consolidation. The prospectus of the National Tube Company stated that the annual net savings of the constituent companies was between two and three millions from 1893 to 1896. The American Window Glass Company reported individual earnings during 1898 of \$2,483,344, American Woolens \$1,750,000 during 1898, and American Smelting and Refining \$1,890,000 during the same year. Similar claims are made by every trust prospectus, and although some of them may be exaggerated for stock market purposes, still, since these figures are average earnings and represent the losses of the weak concerns who are barely above the surface, as well as the larger gains of the strong and prosperous, the

existence of some margin of profit for the stronger firms, even under competitive conditions, and in periods of depression, seems to be pretty clearly demonstrated. But this margin is hardly attained. It is desirable from the manufacturers' standpoint to stop this worrisome struggle, whose benefits are nearly all of them gained by the consumer in low prices. The manufacturers are tired of working for the public. They want a larger profit without such a desperate struggle to get it. This applies to the larger firms, the "money makers," as the American Glass Company's prospectus affectionately styles them. Of course, for the weaker concerns, competition is really disastrous. If they do not find some specialty, competition will eventually drive them out of business.

Many attempts had already been made before 1898 to remedy this troublesome state of affairs. Pools, selling associations and agreements of various kinds had been formed and re-formed. But, based as they were upon free consent, such arrangements were temporary. The collapse of the steel rail pools was expected at regular intervals, and large buyers were accustomed to wait for the break to make their purchases. The "Trust" movement during the eighties promised a more stable regulation.¹ In this form of organization, agreement between manufacturers was secured by depositing individual stocks with trustees, in exchange for trust certificates. These trustees managed the entire business for the benefit of the holders of the certificates. But public opinion and legislative enactment nipped this promising movement in the bud, and manufacturing industry fell back into the wholesome but excruciating struggle of competition. Some attempt had been made after the downfall of the Trust movement to unite competitors under a single company. American Sugar Refining, Ameri-

¹ It is unfortunate that the term Trust should have been applied to the recently-formed combinations, since it does not describe them, but refers to a defunct form of corporate organization. Popular usage, however, compels an adherence to the misnomer, and the reader can only be warned against a misunderstanding.

can Tobacco, United States Cotton Oil, General Electric, and a few other consolidations had been formed before the panic of 1893, and the success achieved by some of them (the Consolidated Steel and Wire Company, for example, according to Mr. Gates, having earned, from 1895 to 1898, 27 and 28 per cent) served to keep the ideal of consolidation in mind until a more convenient season.

The advantages of combination had come to be generally recognized, not only by manufacturers but by the public at large. Whatever the popular opinion of monopoly, the gains of monopoly, exemplified by the oil, sugar and tobacco combinations, were known to be enormous. Officials of these companies might ascribe the large profits to the economies of large production, but the people at large were inclined to attribute them rather to the control of the market which the combination afforded. "Overproduction," the "wastes of competition," and such like explanations of the industrial depression united to emphasize the advantages of consolidation and monopoly. Here then was the promoter's opportunity. On the one hand, the manufacturer was weary of competition and anxious to combine. On the other hand, the public was profoundly impressed with the large profits of monopoly, and eager to share in those profits if opportunity were given, while at the same time railroads had largely withdrawn from the stock market and a speculative demand for new stocks was gathering force and headway. A more promising opportunity to sell stocks had never before been offered to the bold and energetic pioneers of industrial progress, and they hastened to take advantage of an opening so fortunate. In 1898 and 1899, the convenient season for consolidation had arrived, and the promoter came forward with his scheme.

He proposed to the manufacturers that he would organize a company and purchase their plants outright with its stock. Instead of fifty firms, all more or less embroiled with one another, he proposed to substitute one gigantic corporation,

which should take in every plant of importance and make competition impossible. There was to be but one corporation in each industry, one wire company, one glass company, one bicycle company, one company manufacturing tin plate. By selling their plants to the new company and taking its stock in exchange, individual firm owners could either retain an interest in the business, or they could sell their stock and free their capital for other uses. His chief inducement was the prospect of monopoly control by the elimination of competition. Abundant evidence that the desire to escape the burdens of competition was the main incentive to the formation of the trusts, and that those evils, moreover, were the low prices prevailing is to be found in prospectuses and in the evidence before the Industrial Commission. The claim of the National Glass Company has been already referred to. It was to take in "every money-maker in the tableware trade of the country."¹ The American Window Glass Company, in its prospectus, also evidences the chief motive to consolidation. "The advantages of consolidation are shown by the increase of profits in 1898 and 1899, while the small profit shown for 1896 is partly due to the operation of a limited number of pots, it is largely due to excessive competition. In 1897 the American Glass Company (a selling agency) was formed and its beneficial effects were at once shown. It is reasonable to infer that further economies in production will arise from consolidation which will still further increase the profits."² Mr. Daniel G. Reid, president of the American Tin Plate Company, stated before the Industrial Commission that the company was formed "for the purpose of getting together to do away with foolishness in making prices, and competition, I suppose, would enter into that, although there is competition in the field against us."³ In another place Mr. Reid strengthened this ex-

¹ "Commercial and Financial Chronicle," vol. 69, p. 593.

² "Commercial and Financial Chronicle," vol. 69, p. 745.

³ "Report of the Industrial Commission," vol. 1, p. 885.

planation : "It seemed that there would be a good deal more money in the business than there had been in the past ; there would be no cutting of prices down to a losing basis."¹ Mr. William Griffiths, a tin plate manufacturer who sold out to the trust, stated that the prospect of monopoly was one of the inducements which were held out to influence him to sell.² Additional evidence is found in the location and number of the constituent plants. It is a familiar fact, emphasized in every prospectus, that the trusts control the greater part of the output in the industries in which they are formed, 75, 90, and 95 per cent being common figures, but the implication of this statement is not so generally recognized, viz., that they follow in their location the grouping of industry which has just been described, and that they unite under one organization plants which are often thousands of miles from each other, whose only possible connection was that of competition, and where the sole reason for union was obviously the wish to avoid that restraining influence. Take the plants of the American Steel and Wire Company, as one of the best examples of this transcontinental feature of the trust formation.

List of Plants Forming the American Steel and Wire Company of New Jersey.

State.	Name of Plant.	Location.
1. Massachusetts .	{ Washburn & Moen Worcester Wire Co. }	Worcester.
2. New York . . .	Newburg Wire and Nail Co. . .	Newburg.

¹ "United States Industrial Commission," p. 884.

² *Ibid.*, vol. 1, pp. 901-902.

Q. "When these promoters visited you first in the interest of the American Tin Plate Company, did they express anything to you as to the avowed purpose of the formation of this company, or trust? What was the object of the trust? A. Oh, yes; they gave us to understand that if the trust was formed, of course it would hold absolute sway.

Q. And the purpose was, then, to crush competition entirely, and to raise the price of tin plate? A. Of course, they would not say it in as strong phraseology, but they would say it in another way.

State.	Name of Plant.	Location.
3. Pennsylvania . . .	Consolidated Steel and Wire Co.	Allentown. Rankin.
	Salem Wire Nail Co.	Beaver Falls.
	New Castle Wire Nail Co.	New Castle.
	Allegheny Furnace Co.	Allegheny.
	Shoenberger Steel Co.	Pittsburg.
	Oliver & Snyder Steel Co.	
	Oliver Wire Co.	
	A. R. Whitney & Co.	Duncansville.
4. Ohio	American Wire Co.	Cleveland.
	Consolidated Steel and Wire Co.	
	Emma Furnace of Union R. M. Co.	
	Cleveland Rolling Mill Co.	Cincinnati.
	Cincinnati Barbed Wire Co.	
	H. P. Nail Co.	
5. Indiana	Salem Wire Nail Co.	Findlay.
	American Wire Nail Co.	Anderson.
	Indiana Wire Fence Co.	Crawfordsville.
6. Illinois	Consolidated Steel and Wire Co.	Joliet.
		Rockdale.
	J. L. Elwood Mfg. Co.	De Kalb.
	Elwood Wire and Nail Co.	
7. Missouri	Laidlaw Bail Tie Co.	Joliet.
	Consolidated Steel and Wire Co.	St. Louis.
	Laidlaw Bail Tie Co.	Kansas City.
8. Kansas	Consolidated Barbed Wire Co.	Lawrence.
9. California	Washburn & Moen Co.	San Francisco.
10. Washington	Puget Sound Wire, Nail and Steel Co.	Everett.

Observe the vast extent of territory which is here included—ten states in all, with Massachusetts and California at either end of the line. Other trusts show the same thing though on a more limited scale. The plants of the American Sugar Refining Company are located in six states, including Louisiana and California. The Republic Iron and Steel Company is represented in eight states, including Alabama, Minnesota and Pennsylvania. The American Tin

Plate Company has its plants in five states, including Missouri, Indiana and Pennsylvania. The Continental Tobacco Company is located in six states, and the American Car and Foundry Company in seven states. Sometimes, it is true, the organization is local in character, such as the Minneapolis Breweries Company, and the Pittsburg Coal Company or it may, for some special reason of manufacturing advantage, include plants situated in states immediately adjoining, as International Silver, International Paper and the Whiskey combinations; but, as a general rule, the trusts include plants which are so widely sundered that the elimination of competition was plainly the dominant consideration in bringing them together.¹

We may, I think, consider this point to be established. The desire to stop competition was the principal reason for the formation of the trusts, and from the producers' point of view, it was a perfectly valid reason, a reason which would appeal to any of his critics were they placed in a similar position. The suppression of competition has a number of aspects which commend themselves with almost equal force to the producers. To begin with, there is the selling price of the product. If combination is once secured, the unity of action secures a stable price at all times and enables the managers to change their prices with the state of trade in such a way as to secure the largest net return. When business is brisk and the demand is strong, they can take the fullest advantage of the situation by raising prices as high as the traffic will bear. The recent advance in the price of refined sugar is a case in point. Under competitive conditions, individual producers could never be sure that some special arrangement was not being made to their disadvantage, and large consumers could play them off one against the other so as to keep prices below the point to which the demand would naturally carry them. In

¹ List of plants given in "Poor's Manual of Railroads, 1899—" Heading, "Miscellaneous Corporations."

the same way, when prices are falling, the directors of a combination can feel secure against the reckless cuts and sacrifice sales with which hard-pressed firms are constantly threatening the market. They must indeed lower prices at such a time, but they do not make excessive reductions, and by their control of the supply, they can often check the decline and even convert it into an advance. Then, too, in dealing with the railroads, combination gives a great advantage, and in their purchases large corporations enjoy the position of the strongest buyer.

Export trade, moreover, can readily be developed to take off the surplus which stable prices will not suffer to be sold in the home market, and in this way plants can be kept running with greater continuity and larger profit than when every fall in prices means extensive shut-downs. In the same way that railroads charge lower rates on low class traffic which fills westbound cars, and so increase their net earnings by keeping all their equipment in use, the combinations, by making low prices abroad, can work off any surplus upon foreign markets and keep their machinery in more constant operation. This is the same theory of selling which underlies the German protective system, to extend the foreign market by the sale of surplus stock, increasing foreign sales when the home market weakens, and reducing them on a revival of local demands. Export trade is thus used as a "make-weight" to supply the deficiencies in revenue, which result from dull markets at home. Just as the English income tax is used to fill up the gaps in the revenue, so under the system of large corporate organization, the foreign demand is relied on to maintain the level of net earnings.

The advantage of combination in dealing with trade unions need only be mentioned. A monopoly of labor is offset by a monopoly of employment, and the manufacturers' position is much stronger than when each one has to meet unaided a great labor organization. Other advantages are

found in concentration of office force, distribution of special processes, advertising, cross-shipments and saving in selling agents. These, however, are of minor importance. The management of the industry has not been much changed. Particular markets will continue to be supplied from the nearest plants, just as they were, in largest part, before, a fact which greatly weakens the claim for economy in cross freights. Moreover, if the combination wishes to push its goods it must advertise. The National Biscuit Company has succeeded by increasing its advertising.¹ As to the distribution of special processes, this is no doubt an advantage, but in the lines of industry where trusts have been most largely formed, raw materials and half-manufactured products, its importance may be easily exaggerated. It should be remembered that many plants in each trust are already equipped with the best machinery before they enter the combination. It is true that a harshly critical and censorious public opinion has compelled the trust officials to exaggerate the importance of these minor economies of combination and studiously to conceal their hope to control prices, but these minor savings upon which such labored emphasis is put, are evidently reflections from the greater advantages of controlling the supply, and the inconveniences which they dispense with were made necessary by competition and competitive prices.

(b) *Cash or stock bonus offered.*—This inducement of the elimination of competition, although powerful, was not in all cases sufficient to secure universal consent to enter the combination. The weaker firms, indeed, to whom independent existence threatened destruction, gladly accepted, without quibble or dispute, the offer to take shelter under the wings of the trust. With the stronger firms, however, there was often more trouble. These, it will be remembered, had been making money. They were in no way forced to combine, and to many of them the prospect of being swallowed

¹ "Commercial and Financial Chronicle," August 26, 1899.

by a trust was not pleasing. To them other and stronger inducements must be offered. Moreover, shrewd business men in control of large plants know that their co-operation is essential to the formation of the trust. If strong competitors refuse to combine, the attractiveness of the proposition is much diminished, and it is likely to fall through. Indeed, the union of all the important plants is deemed to be quite indispensable. The organization of the Continental Tobacco Company, for example, was delayed several months until terms could be made with Liggett & Meyer, of St. Louis, whose competition made successful control of the plug tobacco trade very uncertain. This anxiety on the part of the promoter to secure the consent of strong firms to sell out to the combination, in order to make his proposition as attractive as possible to the stock market, offers a basis for cash negotiations, and enforces the necessity of cash payments to reluctant and desirable firms. Liggett & Meyer received from the Continental Tobacco Company \$12,500,000 in cash for their plant, and the American Steel and Wire Company had to provide \$15,000,000 for the purchase of plants. Even when the plants are not purchased outright a cash bonus has often to be given, varying in amount with the importance of particular plants to the combination, which is necessary to put it through. These bonuses and payments come under the head of "special arrangements" which must be made by the promoter, putting him under the necessity of financing the trust by raising the money.

He has two ways of meeting these difficulties, (1) by a special inducement in the exchange of stock for plants (his original proposition to all alike), and (2) by the sale of stock to underwriters. A weak firm, as just indicated, is glad to get in on any terms. The promoter agrees upon a value of the plant and pays for it in preferred stock, usually at par value. The firm owner here merely exchanges his earnings for the greater certainty which the preferred stock offers him. This does well enough in the majority of plants. With strong

firms, however, as just noticed, an extra inducement must be offered. In such cases the preferred stock is given for the value of the plant, varying in amount with the strength which each owner shows in bargaining and the amount of trouble he would probably make if his terms were not acceded to; also depending, in many cases, upon his relations with the promoter, and in addition a certain amount, usually one share of common stock, is given with each share of preferred. The advantages of this arrangement to the firm owner are obvious. His preferred stock protects him in a prior claim to 6 or 7 per cent of net earnings, and he can sell the common stock at 35 or 40 without endangering his preferred. He has received an interest in the new combination equal in value to the plant which he sells, and in addition what amounts to a present of one-half the value of his plant in common stock. The common stock of American Tin Plate sold above 30 until December, 1899, of American Steel and Wire above 45 during the same period, while Continental Tobacco, International Paper and Federal Steel, common, also maintained a good value throughout most of 1899. There was no difficulty in realizing a substantial amount of cash through the bonus of common stock. It is not strange, under these circumstances, that the firm owners, although offered the choice between cash and stock, in the great majority of cases chose the latter. If they took cash, they would get the value of the plant. If they took stock, they got the value of the plant in preferred, and what the common would sell for in addition. Another inducement has been the offer of situations as general officers or district managers to influential stockholders and firm owners. These positions carry high salaries and great distinction. The promoter makes these arrangements and appoints the officers before he parts with the stock. After that they must see to their own positions. This inducement, it will be noted, is so much extra gain to owners who are not already in receipt of salaries, and compensates salaried owners for the loss of their former positions.

This general acceptance of the bonus of common stock as an equivalent for the superior value of strong firms to the combination, although expected, could not be counted upon with absolute certainty. Cash might be demanded and the entire amount necessary to buy all the plants thus circumstanced must be provided by the promoter. In some cases where cash was demanded, however, the combination could not be financed. American Potteries, for example, fell through, because the firm owners demanded more cash than the promoter could furnish. Moreover, there were some plants to be paid for outright, and there were the debts of others to be provided for. A large amount of cash was required for these purposes and to obtain this cash the trust must be underwritten.

Another means might be resorted to. The new company might issue bonds to the minimum value of its plants and thus obtain the necessary funds. It might at least guarantee the bonds of the constituent companies and refund their floating debts into its own securities, in this way lessening the amount of the cash payment. But for many reasons the issuing of bonds is not desirable. It very materially lessens the attractiveness of his proposition if it includes a stipulation that the plants are to be put under a mortgage. The firm owner with his preferred stock, both as to earnings and assets, can probably get his plant back again if anything goes wrong, but if he consents to put bonds ahead of his stock he may suffer heavy losses in a reorganization. The incurring of indebtedness also lessens the value of the stocks and it is necessary that stock should be sold. So long as a company is out of debt it cannot go into bankruptcy, and its stockholders are safe from reorganization assessments. A mortgage lien, however, especially when the enterprise is new and untried, makes its success much more doubtful. Moreover, the bonds of a new enterprise must be sold at a heavy discount. A recent issue of trust bonds, underwritten at 92½ by one of the largest houses in New York,

brought only 70 in the market. For these reasons but few bonds have been issued by the trusts. During the first six months of 1899 only \$119,800,000 of bonds were issued by the trusts as against \$3,022,000,000 of stock.¹ Where bonds have been issued, debentures and income bonds upon which interest need not be paid unless earned, have been generally employed, or if the bonds carried an obligatory interest charge, a sinking fund clause has provided for their early retirement. The Federal Steel Company assumed \$30,000,000 of the bonds of its constituent companies, and the International Paper Company has issued \$9,000,000 of bonds out of its authorized bond issue of \$10,000,000, but these are the only important exceptions. This is in striking contrast to the practice of the railways. The total bonded debt of the Chicago, Burlington and Quincy, Illinois Central, Chicago, Milwaukee and St. Paul, New York Central, and Pennsylvania railroads amounts to \$642,000,000, while their combined issues of stock are \$421,000,000. The trusts, however, are not to be criticised for refusing to mortgage their plants. As just remarked, it would be difficult to float the scheme, if fixed charges were placed ahead of the stock, and besides this an easier and safer way to raise cash is open to them, namely, by the issue of extra stock whose sale is secured by previous arrangements.

II. Two methods are employed to secure the sale: (a) underwriting, and (b) the sale of privileges.²

(a) *Cash purchases and underwriting*.—The underwriter insures the sale of securities at a certain price—lower than the market price by a margin sufficient in his judgment to

¹ "Commercial and Financial Chronicle," vol. 69, p. 57.

² This issue of stock, above what is necessary to pay for the plants purchased for stock, for a large part of its amount is really not an extra issue at all, but represents an indirect exchange of stock in the acquirement of properties or in the payment of debts, both of which strengthens the earning power of the combination. In so far as common stock is issued for underwriting commissions, the matter is no different from giving it as a bonus to firm owners. In one case stock is given directly for plants, in the other it is given indirectly by being first sold to the underwriter.

secure him against loss. A first-class bond selling at par will usually be underwritten at 98. A fluctuating industrial selling around 60 will be underwritten at 50 or 45. The underwriter agrees to take the stock at the price fixed upon if it is not sold within a stipulated time. In return for this guaranty he receives a bonus of stock, which, in some cases, is very large. Seligman and Company, for example, are reported to have received \$11,000,000 of common stock for underwriting the American Steel and Wire. Of course the risk was great, and in this particular instance the decline in the stock to 30 within a few months greatly diminished the value of the bonus. If enough securities are sold to provide the necessary cash the underwriter makes the entire value of his commission. If the shares cannot be sold he makes up the amount of cash lacking by purchasing stock at the price agreed upon. Underwriting has usually been undertaken by private bankers and trust companies. The entire responsibility is seldom assumed by the underwriting firm. Their business connections are admitted to a share in the responsibility and the commission.

(b) *The sale of privileges.*—The second method, one which has been frequently employed to finance combinations, is the sale of privileges. A privilege in trust finance is the right to receive in exchange for \$10,000 one hundred shares of preferred stock and a certain amount—usually one hundred shares—of common. The value of the privilege is the difference between the value of the shares and \$10,000. This same privilege was offered to the principal manufacturers in lieu of a cash payment. This method of underwriting was followed in the case of American Tin Plate. Judge Moore explained the method to the Industrial Commission as follows: “There has been no underwriting, what is technically known as underwriting, in any of these. Bankers and capitalists all over the country, after it was known I had made a success of this organization, applied by wire, letter and telegram to subscribe for the capital

stock.”¹ Besides American Tin Plate other examples of privileged financiering are National Distilling, National Biscuit and American Car and Foundry. The value of these privileges has already been shown in discussing the inducement offered to firm owners to accept stock for their plants instead of cash. As long as the value of preferred and common together exceeds \$100 there would be no difficulty in raising money by the sale of privileges. The highest value of the privilege in the National Biscuit during the last two years was $57\frac{1}{2}$ in February, 1899, and of American Tin Plate $39\frac{3}{8}$ in August, 1899. This does not mean, however, that all the stock taken by underwriters was disposed of at these figures. The stock must be worked off gradually as the market was able to bear it, and any attempt to hurry matters would have made the privileges worthless. As it was, their value in December, 1899, was only $26\frac{7}{8}$ for National Biscuit and $5\frac{1}{8}$ for American Tin Plate. This method of financiering does not differ essentially from underwriting proper. In either case, it is the bonus of common stock which offers a profit on the transaction. The sale of privileges is preferable wherever it is possible to interest the firm owners more largely in the combination by selling stock to them on this basis. Judge Moore stated before the commission that the firm owners, as soon as they saw that the combination would go through, were anxious to take the stock which had been set aside for a syndicate.²

III. *The profits of the promoter.*—The work of the promoter is now ended, and the amount and manner of his profits may next be considered. The gains of promoters are contingent on their success in buying plants and making underwriting arrangements. They seldom put any money into

¹ “Report of the Industrial Commission,” vol. I, p. 963.

² I have given in the foregoing the most common methods of exchange and underwriting. In the multitude of consolidations which have been financed during the last two years there has been room for a great many deviations from the forms here described.

the combination, and whatever stock there is left after the arrangements are completed constitutes their profit. Their situation is analogous to that of a railroad construction company. There the practice is for a few men to form a company and obtain a franchise to build a railroad. On the strength of this franchise they issue as many bonds as they can get underwritten and a certain amount of stock in addition, an amount very often equal to the bond issue. Then these same persons form a construction company to build the road, taking their pay from themselves as a railroad company in bonds which carry with them as a bonus the greater part of the stock. The profits of the construction company consist of the difference between the cost of the road and the amount obtained for the bonds and stock. These profits can be increased by diminishing the cost of the road, and they also depend on the price obtained for the securities. On a rising market, when securities find a ready sale, these profits are large. On a declining market, however, in spite of the excessive compensation which the construction company often allot to themselves, their operations may often result in heavy losses, if the securities cannot be sold for the cost of the road. The trust promoter is in much the same position. He forms a company and obtains a charter which authorizes him, among other things, to purchase manufacturing plants. The company then issues preferred and common stock, the preferred stock presumably equals the value of the plants, while the common stands for the economies of combination. The promoter now uses the stock to purchase the plants. Some of it he is obliged to give away in bonuses to secure the consent of the stronger firms and to reimburse the underwriters. If the plants can be purchased and the underwriting secured with less than the whole issue of stock, the promoter makes a profit by the sale of the stock which is left. This profit depends on forcing favorable terms from firm owners and upon the condition of the stock market. We can now understand the invariable se-

crecy which surrounds the dealings of the promoter with the firm owners. Every effort is made to prevent any knowledge of the amount of the options from getting abroad. Judge Moore stated the matter as follows before the Industrial Commission: Q.—“At any time did any manufacturer know the option of any other manufacturer?” A.—“Not if I could keep it from him.” Q.—“So there was no opportunity for comparisons?” A.—“It was a business transaction. Each manufacturer imagines his plant is better located; better than his neighbors’; he knows it is; he has no doubt about it.”¹ The inference is so obvious that I need do no more than call attention to it. By keeping each manufacturer in ignorance of the terms offered to every other, the promoter is able, even as between plants of equal value, to make better terms with some owners than with others. He can take advantage of individual ignorance of the general situation, and can often magnify the advantages of combination, while those with whom he is dealing have no opportunity by comparing notes, to learn just how indispensable each of them really is to the combination, and so to mutually strengthen each other’s demands. This is one aspect of the promoter’s profit, the other is conditioned upon the prices obtained for the stock. So far his situation is identical with that of the construction company. He forms a company to accomplish certain results through the exchange of the securities of that company. His profit depends upon the amount of securities which he has remaining and upon their value.

There is one point, however, where the comparison breaks down. The trust promoter has not the same risk of loss as the construction company, which actually undertakes the work of construction. In the case of the railroad, if the securities do not sell for the cost of the road, the construction company which has obligated itself to the contractors suffers a loss.

¹“Report of the Industrial Commission,” vol. 1, p. 961.

The trust promoter, however, has assumed no obligations nor any risk excepting those connected with his reputation as a shrewd and successful man of business. If he fails to purchase the plants with the securities which he has in hand the combination merely falls through, things go back to their original status. The promoter seldom makes contracts which obligate him to expend money that he cannot obtain by selling stocks. Promoters' profits, therefore, do not represent compensation for risk, but merely for services rendered, and so have not the same justification, if indeed any justification is required, as the profits of the railway pioneers. The trust promoter does not construct, he merely combines what is already constructed. The net result of the trust movement is not, like the work of the railway promoter, a large capital expenditure; it is merely a change of ownership and organization. Whatever risk is assumed in these operations is assumed by the underwriter. Speculation as to the probable amount of these promoters' gains is unprofitable. These profits depend upon two quantities, the amount of the stock remaining in their hands and the price obtained for that stock, and both of these quantities are unknown.

IV. We come now in our inquiry to the stock market. The company has been organized, the options secured, the shares exchanged, the underwriting provided for, the officers selected by the promoter, and the company put in operation. The immediate profits of consolidation must now be realized and to this end the stock must be sold.

The sale of stock.—The promoter, unless he retains an interest in the new company, must sell his stock to make his profits. The underwriters have large blocks to dispose of, both of preferred and common. The firm owners have their bonuses of common to sell, and many of them welcome the opportunity to release their capital and turn it into other investments by selling all the trust stock which they hold. Roswell P. Flower, for example, was a large owner of paper

mills which he was instrumental in bringing into the International Paper Company, receiving its stock in exchange. In the settlement of his estate it was found that that he held only one share of preferred and one thousand shares of common stock of the International.¹ All these stocks must be sold to some one if their holders are to realize their expected profits.

Classes of investors.—Trust securities cannot be sold to the true investor. The trust is a new enterprise and its success, while perhaps not doubtful, is yet far from being so certain as to warrant a confident expectation that its dividends will be such as to commend it to the favor of conservative investors. An investment security is one whose rate of return is safe, stable and permanent. It is purchased for what it is worth at the time of purchase, and in the expectation that it will maintain about the same value; certainly that its value will not greatly decline. The true investor—qua-investor—is not a business man. He surrenders the chances of large profits and the risk of losses equally large, in return for the assurance of certainty in a fixed income upon which he can depend at all times, and which is not conditioned upon his constant care and effort. Indeed, the value of investment securities depends more upon their permanence and security than upon their rates of return, a fact which is evidenced by the high value of government bonds and hundred year railway first mortgage bonds. The true investor is not a risk-taker, and investment securities are those from which the element of risk and fluctuation has been almost entirely eliminated. Trust securities do not conform to these investment requirements. They represent an experiment. Their success is yet to be demonstrated. Worst of all their legal and political standing is not yet assured, and their business methods have not yet attained that degree of frankness and conservatism which would commend them to a careful investor. For these

¹ "United States Investor," March 17, 1900.

reasons the shares of the new trusts can look for little investment demand.

There is another class of investors, however, to whom the securities of the combinations offer a most tempting inducement. These are the speculative investors. They may in their turn be divided into two classes. The first class is represented by such a man as Russell Sage. Holding a large amount of money constantly in hand, they are on the lookout to buy stocks and bonds which for one cause and another have fallen below their intrinsic value. The securities of reorganized railroads furnish a large field for their activity. Every time of financial stringency which forces large sales of first-class securities and pulls down the price of the entire list, finds these "panic birds" ready to pick up the bargains. They are reasonably sure of large and quick returns on such purchases, because the low prices at which they buy are evidently due to exceptional and peculiar conditions which are certain to pass away, relieving the pressure and bringing prices back to their normal level. These speculative investors, be it repeated, operate chiefly in times of financial stringency. They are the only ones who profit from bankruptcy and depression. They are not in the market for trust securities, and indeed have been largely interested in the underwriting. They are sellers, not buyers of trust stocks.

Eliminating the shrewd speculative investor, we have left a class of investors who are not so shrewd. These are the people of moderate means and moderate intelligence who buy the shares of new companies at a low price, trusting in the representations of the promoter that they will pay large dividends and greatly increase in value. They are tempted by the offer of 12 or 15 per cent to buy securities which are very likely to be worth nothing. The promoter is indeed the pioneer of progress. He takes great risks and runs long chances, but he risks the savings of the great middle class who are ready in every period of inflation to

forget the past and trust him once more. The appeal of the promoter to the investor is illustrated by the following extract from a mining prospectus:

"Bell Telephone was given away for board bills yet has paid over \$36,000,000 in dividends. Calumet and Heckla went begging not so many years ago—its total dividends to date are over \$60,000,000. . . . It would take a day to enumerate the instances where properties rich and great to-day were offered for a song. The people who did buy them are rich now, and why? Not because they were "lucky" but because they investigated promptly, judged the merit of the proposition, and acted while there was time. If they had waited until to-day to buy the shares of these enterprises they would get perhaps 5 per cent on their money—possibly eight—but no more. But buying when they did, they got all the way from 50 per cent a year up to 500 per cent because they had both the judgment to recognize the worth of the opportunity and the courage to seize it. A thorough examination of the details of the Arizona Copper Syndicate will satisfy any man of judgment as to its merits. It is one of the greatest opportunities ever given investors. Investigate it now while the price is low."

Inducements to speculation.—Here are the principal inducements to the speculative investor in every new enterprise. Other men have had similar chances and have made fortunes. Why should not he be equally successful? He is not asked to gamble, he is asked to "investigate" an industrial opportunity and act only as his judgment directs. He may be half conscious that the promoter is a liar and that his prospectus is worthy of its author. He may have even been mulcted by similar schemes in the past, but he is carried away by the prevailing optimism of the time; he "feels good," as the saying is, and is ready to listen to the advocates of new schemes for getting rich. Other people are making money fast and he is perfectly certain of his ability to do as well as they. The appeal to his "judgment" and his "courage" is the bit of flattery which is often decisive. When once embarked on a doubtful enterprise he is impelled by sentiment and interest to draw others along with him. Every speculative investor is a promoter. He is zealous in

his advocacy of the enterprise to which he has committed his money. His enthusiasm is infectious. Others are drawn into the net by his representations and they in their turn compass sea and land to make one proselyte. In this way, the wave of speculation is set going and sweeps through all classes of society turning the accumulations of years of effort into the treasuries of the new companies. The situation is universally familiar. A minister or a merchant has a few thousands laid by, a woman has either saved or inherited a small amount, a workman or a farmer has managed to scrape together a few dollars for a rainy day. Such people are found by the thousands all over the country. From their accumulations they draw a small rate of return, often so small that they are constrained to add it to the principal, and do not venture to apply it to expenditure. Four or five per cent clear gain is about all that can be expected. Their lives are hard, monotonous, and infinitely barren. Before their eyes is constantly flaunted the seductive spectacle of leisure class consumption, spurring on their desires which are certain in any event to outrun their means. To such people the prospectus of a new enterprise is wonderfully attractive. In exchange for a few thousands it offers them a fortune. The offer dazzles them. Their desires benumb their small judgments. The risk of the undertaking is forgotten. No investor in a speculative scheme enters it with the thought of risk in mind. The calm balancing of chances is the exercise of a superior order of mind. The speculative investor does not buy a chance, he buys what he thinks is a fortune. The line of speculative investors is very ancient. In 1720 there was printed for W. Bonham in London, "an argument proving that the South Sea Company is able to make a dividend of 38 per cent for twelve years—fitted to the meanest capacities." This was one of the first propositions ever issued and the succession has been worthy of its ancestor—Spanish Jackass Company, Louisiana Bubble, South American Bonds, American Improvement Bonds, English Rail-

ways, American Railways, American Mines, South American Railways, Australian Railways, Rand Mines, American Industrials, John Law, Hudson, Barnato, Hooley, MacIntyre, and Lawson. The line runs true. The Spanish Jackass Company still lives.

The prospectus.—The trust puts out a prospectus which differs from that of the Arizona Copper Syndicate only in form. Here is a specimen:

“The International Paper Company, of New York, was incorporated January 1, 1898. It at once took over by purchase twenty-five of the principal pulp and paper mills of the country, which produce from 70 to 90 per cent of all the newspaper manufactured east of Chicago. The average daily output of these mills is: ground wood pulp, 1,050 tons per day; sulphite pulp, 256 tons per day; finished paper (nearly) 1,500 tons per day. The leading manufacturers retain their interest in the industry and many of them are giving their time and energy to the promotion of the business of the new company. The company has issued the following securities, the large majority of which have been used in payment for the mills, water power and woodlands acquired by the new corporation: First consolidated mortgage, 6 per cent gold bonds, \$10,000,000 preferred stock, cumulative 6 per cent, \$25,000,000; common stock \$20,000,000. The appraised value of the property securing the above named bonds is \$40,000,000. Net earnings are now more than sufficient to pay the interest on the bonds, dividends on the preferred stock and 10 per cent on the common stock; while indications fully sustain the belief that they will be even higher in the future. Regarding competition it can hardly be expected to prove successful, if attempted, for the valuable water power and timber lands—400,000 acres of the latter being held—could not be easily duplicated or acquired.”¹

It is no gold mine or land company which the trust promoter has for sale. He fathers no wildcat schemes. He appeals to the “investor” not to the speculator. He has organized the manufacturing industries of the United States into great companies, whose members have already succeeded in their individual capacity, and which cannot fail to achieve far greater success when combined. He will sell

¹ “Commercial and Financial Chronicle,” July 23, 1898.

them a stock at forty or fifty, which *must* pay at least 6 per cent on its par value, offering them 12 per cent on their investment. Nearly every prospectus contains this statement. The preferred stock represents the capitalized earnings of the plants before consolidation and all the economies are to go to the common stock. The common stockholder is to be the residual claimant. The preferred stock is represented to be no better off than it was before, but the common is to reap the full fruition of the great step in industrial progress which has been taken. Here is a double inducement, a high rate of interest, or a quick realization of large profits, for the stock is certain to go higher. There is no manner of doubt about it. Here are the properties. Their value has been carefully investigated by expert accountants and preferred stock issued to represent that value. Here are the economies of combination—so much from advertising, so much from freights, so much from patents, a large amount in addition from control of the market. Everything is open and above board. There is no concealment whatever. According to the promoter the thing is practically certain. The prospectus of the International Silver Company is a good illustration of the nature of these promises to the common stockholder:¹

SAVINGS BY CONSOLIDATION.

	Present Expenses	Reduced To
Salesroom and clerk hire	\$375,000	\$100,000
Travelers' salaries	350,000	125,000
Travelers' expenses	400,000	75,000
Clerk hire, etc.	275,000	50,000
Designers, machinists, etc.	225,000	75,000
Advertising	200,000	50,000
	<hr/>	<hr/>
	\$1,825,000	\$475,000
	475,000	
	<hr/>	
Total saving	\$1,350,000	

¹ "United States Investor," May 19, 1900.

PAYMENTS.		
	Present Expenses	Reduced to
6 per cent int. on \$3,500,000 bonds . .	\$210,000	\$1,350,000
7 per cent div. on 4,500,000 pre. . .	315,000	526,000 ¹
10 per cent div. on 10,000,000 com. . .	1,000,000	1,876,000
	<hr/> \$1,525,000	<hr/> 1,525,000
		<hr/> \$351,000 ²

Common stock purely speculative.—The stock of International Silver was originally offered around 50, so 20 per cent was promised on an investment in its common stock. Nearly every prospectus contains, expressed or implied, a similar assurance of common stock dividends. The common stock of the trusts was certainly a very attractive proposition to the speculative investor. Moreover, competent and authoritative opinion was not lacking to influence the wavering and uncertain investor. The underwriting privileges had been sold “all over the country.” Financial houses and moneyed men everywhere had been let in for a share of the underwriting and had stock to sell. Besides this, there were a large number of manufacturers in all the industrial centres who wished to realize on their bonus or on their preferred stock. These institutions and individuals have a large following among this class of investors, and their opinions upon financial matters are held to be very weighty. The influence which can be exerted in favor of the new securities is something tremendous. There need be no direct solicitation. That would be undignified, and might make trouble between friends if anything went wrong. More than this, direct solicitation is unnecessary. As Bacon remarks in his essay on “Cunning,” “it workes better when anything seemeth to be gotten from you by question than if you offer it of yourself.” This advice to buy stock is almost always “gotten by question” and is disin-

¹ Earnings before consolidation.

² Surplus.

terestedly given. The news of the formation of the trusts is in everybody's mouth. Their prospectuses are in the newspapers. Imagination magnifies their really enormous extent and power, and the profits which they will realize. And their stock is now offered to the public at a low price. What more natural than to consult with one's financial adviser and what so conservative as his opinion. He advises no one to buy, or if he ventures so far it is always with the caution that "something may go wrong," that bit of caution which establishes him firmly as a safe adviser. He lets it be understood that he thinks well of the proposition; moreover, that he is personally interested in it, and he merely suggests that it is worth "investigating." In such matters he who investigates is lost. The advice is usually taken and the stock is sold. The underwriters and those who are interested in selling stock had only to let it be known that they considered the trust stock a "good thing" to gather in the wool of the whole country. A large amount of trust stock has been sold to this class of investors.

There is another class to whom stock can be sold. These are the margin speculators, the gamblers who bet on the turn of the stock market. By depositing a small per cent of the market value of any security with a broker he will borrow money and buy stock for them, loaning them the difference between their deposit and the value of the stock, and holding the stock in his vaults. His customers pay him interest on the money borrowed to buy the stock—a higher interest than he himself pays to the bank; and in addition one-eighth per cent commission on the par value of the shares purchased. The broker will buy or sell the stock as his customers may direct. By depositing \$100 and paying interest and commission, the speculator can become the nominal owner of twenty shares of stock which is selling around 50. Suppose the stock goes up ten points, he doubles his money, less the commission and interest. He may also purchase an option to

deliver stock in the future at the price now ruling. If the stock falls, he can buy in for delivery and make the difference. In the case of a purchaser for a rise, if the stock declines, he must deposit "more margin" with his broker. Failing to do this he loses the amount of his first deposit. If the stock continues to decline the weaker holders are gradually sold out and the securities pass into the hands of the stronger speculators, who are either carried by the brokers or who finally, growing weary of paying interest, buy the stock outright and hold it for an investment.

The attractiveness of this form of gambling is very great. It is so much like "business," so much apparently depends on the judgment of the buyer and comparatively so little on the turn of the wheel or the chance of the draw. Every class is represented among the margin speculators. Business men and professional men are found in the better offices; clerks, teachers, ministers, and a host of women, frequent the intermediate grades and the bucket shops. The promoter may reckon with this class, and it is to his interest to impress them with the favorable outlook for his enterprise in order to persuade them to buy for a rise. The outside buyer is almost always a bull. His demand is not an investment demand. The margin speculator does not want the stock and is apt to sell on a slight advance. He puts his money into margins in the belief that the stock will advance. The more seductive are the representations of the promoters, enforced as they are by the "tips" of the brokers, the larger will be the buying for an advance. As the stock goes up, the profits realized are turned back into new margins and the advance gathers strength as it proceeds. Indeed, it often happens that the value of a speculative stock may be carried high above its investment value as indicated by the earnings of the property. The buyer for investment is, however, the half seen goal of the outside buyer. The investment demand always looms ahead, and he deposits his margins in the belief that the market value

is still below the investment value. A stock whose value is highly uncertain, fluctuating within wide and irregular limits, affected by every breeze of rumor, such a stock as American Sugar common, for example, is also a favorite with the outsiders. It is so delightfully uncertain and there is always the chance that when it falls it will rise again. The trust stocks have all been of fluctuating value and so have been popular with the margin speculators. The inducement to engage in these operations is the same desire to get something for nothing or rather much for little, which animates the investor proper. Stories of successful operation are widely heralded and losses are generally kept secret. One incident of the last boom in the stock market was the story of a messenger boy who started in with \$50 and quit with \$23,000. Such stories, like the advertisements of the Louisiana Lottery, point the way to a desirable addition to a limited income. The psychology of gambling, however, is a study by itself and need no longer detain us.

Just in what way does this gambling furnish capital to the new enterprises?—Simply in this, their securities are wanted for gambling material by the brokers. They are the “chips” with which the public play the great game of speculation. The operation is something as follows: The surplus cash of the country is sent to New York City. This money can be recalled at any time and so the greater part of it is not available for time loans. It may, however, be loaned on call. The brokers borrow this money and buy speculative stocks with it. They also borrow large sums on time loans to carry their larger customers. So far as the promoter and underwriter is concerned it is the same thing as though the broker was a legitimate investor. Their only object is to make the enterprise as attractive as possible to the public, so that the demand for speculative material may be large. The brokers on their part use the stocks for collateral at the banks, together with other securities to support its wavering value, and make up the difference between the market price

and the value which the bank puts upon the stock as collateral—usually about ten points below its market value—by the margin which they require from their customers. Thus a large part of the surplus funds of the country are turned over to the founders of new enterprises through the channels of speculation. The money which they get for the stock is borrowed money, but that makes no difference to them—they do not borrow it. The larger the demand for their stocks from margin speculators, the larger is the amount of money which is borrowed by the brokers and turned over to them. The amount of this demand is very large. On September 7, 1899, the call loans of the national banks of New York City amounted to \$129,000,000.¹ Almost all of this was loaned to speculators and much of it on industrials. This money was turned over and over again and constantly replenished by new margins so that it might pass more than once in original exchange for industrial stocks. The amount of margin speculation is enormous. The total number of shares listed on the New York Exchange does not exceed 60,000,000,² and the total number sold in 1899 was 176,421,135. On the basis of these figures each stock was sold three times over. But this average does not give a true picture of the situation. Most of the railway stocks are held for investment and do not come into the market. On the other hand, the industrials, owing to their wide and erratic fluctuations, have been abnormally active. The weekly sales of American Sugar have frequently exceeded the entire issue of the stock. The demand for speculative material has been very active, and the trusts have furnished most of the supply.³ For the week ending June 16, 1899,

¹ "Report of the Comptroller of the Currency," 1899, vol. i, p. 422.

² This estimate is approximately correct for the shares whose prices for 1899 are given in the "Financial Review."

³ Another cause of large profit to the stockholders in control of these enterprises is the large gains from pool manipulation and from inside information. American Sugar is worked up and down several times a year in this way, and the case of John W. Gates with his three and a half million dollar check is still fresh in mind.

for example, the sales of American Sugar common were 435,000 shares, although the entire issue was only 375,000. American Tobacco and Continental Tobacco, together with the steel stocks have also been great favorites with the speculators, because of their rapid and wide fluctuations. On the other hand, the railroads have been largely neglected of late years. They are popular during an advance, on the certainty of large earnings but their value is so well settled that they, with the exception of a few street railways like Metropolitan and Manhattan Elevated, offer but little inducement to margin buyers. Some few issues, such as Missouri Pacific and Union Pacific are still popular, but most of the railway stocks are now firmly settled upon an investment basis.

V. *The collapse of the common stock.*—The trust stock has now been put upon the market. Much of it has been sold to investors. The brokers have large holdings. The firm owners, the underwriters and the promoters have the cash. The next thing in order is the payment of dividends. Dividends on the preferred stock of the industrials have almost invariably been paid in full and without difficulty. The trusts have lived up to their contract with the preferred stockholders, that is to say, the preferred stockholders have lived up to the agreement between themselves. The common stock, however, presents a more interesting situation. This, it will be remembered, was to receive dividends from "the economies of combination." Let us examine the fortune of the common stockholder. Are his hopes to be realized or is the value of his stock to decline, until like the continental currency, it "falls gently asleep in the arms of its last possessor?" The following table shows the value of the common stock of sixteen of the recently formed combinations on June 23, 1900, together with their value at the time of admission to the exchange and three months after that date, and also the rate of dividend up to the close of 1899:

NAME.	Value Month of Admission to Exchange.	Highest Monthly Value, 1899.	Value July 13, 1900.	Rate of Dividend, 1899.
American Car and Foundry . . .	20 15-16	. .	15¼	None.
American Ice	40	. .	35½	At 4 p. c.
American Malting	27¼	32¼	3½	None.
American Smelting and Refining	54½	. .	37 1-16	None.
American Steel Hoop	39 15-16	65	19	None.
American Steel and Wire (new)	46½	. .	32 7-16	None.
American Tin Plate	40 15-16	47 3-16	21½	None.
Continental Tobacco	53¾	. .	25½	None.
Federal Steel	53½	66¼	32½	3¾ p. c.
International Paper	57½	64¾	22¾	2 p. c.
International Silver	32½	. .	4¾	None.
National Biscuit	32 11-16	55½	29¾	At 4 p. c.
National Steel	52¾	55½	23½	None.
Rep. Iron and Steel	25 13-16	29 9-16	12	None.
Union Bag and Paper	40	. .	13¾	None.
United States Flour Milling	41½	. .	Extinct.	

These are the combinations which promised a good return on the common stock. Something has evidently gone wrong. Not only do the stocks bear a low value but their value has fallen from the early quotations, from 25 to 75 per cent, and this within two years from the time of listing. The case is even worse than is represented. Not a single one of the combinations organized since 1898 has paid a good return on its capital stock. Out of 78 combinations listed on the New York Exchange there are only two industrials whose common stock bears a price over 50. Most of the others are worth less than 40. Many of the common stock values are much lower than those given in the table. Here is Empire Steel, for which 3 is offered, United States Leather selling at 9, Natural Starch at 6, and Union Steel and Chain at 3. In the worst days of railroad speculation there was never such a large proportion of low-priced stocks and these values are made when the prices of commodities are high and when general business is very active. If the common stock suffers so much now, what will happen to it in times of stringency? "If in the land of peace, wherein thou trustedst,

they have wearied thee, how wilt thou do in the swelling of Jordan?"

The public has been much befooled. So much is evident. This, however, is nothing unusual. They and their ancestors before them have had the same experience with other propositions. The collapse of the common stock of the trusts is no new thing and might have been expected—in fact, was expected by conservative investment interests from the first. The United States Investor, for example, has insisted all along that the common stock of the new industrials was practically worthless. The speculative investors had plenty of warning, just as they have always had. It is the South Sea Company and the Louisiana Bubble over again; the same prospectus, the same promises, the same pointing to the eminence of the promoters and their high character and financial standing. The South Sea pamphlet which has already been quoted has a sentence or two with a strangely familiar ring: "Is it not the greatest absurdity to imagine that such a number as thirty (most of which, if not all, were before allowed to be men of Sense and Honor), should all, and everyone, on the sudden, concur in such a monstrous piece of villainy?" and the question is answered two centuries later by the Investor: "A more palpable fraud was never attempted. A lot of men, many of them persons of respectability, get together and conspire to unload hundreds and thousands of industrials on the public at several times their present or prospective value and in order to effect this end they make representations regarding the future earning power of the industries, the ridiculousness of which no one is in a better position to understand than themselves." The trust movement then, in its common stock feature, represents a gigantic swindle, the most stupendous and successful attempt at financial dissimulation that the world has ever seen. The current explanation is "over-capitalization" and the remedy offered is "publicity." A recent

writer on the subject has voiced the opinion of the Industrial Commission:

"The only just method of preventing the evils which are likely to come about through the capitalization of any establishment is to put clearly and fully before all investors, at the time of the organization, the plan of organization itself, the amounts actually allowed for all and each of the properties taken into the establishment, with as complete information as possible regarding these properties, so that a fair judgment can be made regarding their cost and earning capacity."¹

General opinion has echoed the statement, the trust officials themselves have endorsed it—let us have publicity in such matters, it is argued, and all will be well. This explanation and the remedy suggested are not entirely applicable to the situation presented by the failure of the trusts to pay dividends on their common stock.

To begin with, so far as the preferred stock is concerned, the result has borne out the representations. Preferred dividends have been earned and paid as promised. The manufacturer who sold his plant for preferred stock has received full value for his money. So it is the common stock only that is to blame for the disturbance. But there was less secrecy about the common stock than is generally supposed. It is true that many plants were put in at excessive values, and that more stock was issued than necessity required, but this does not represent the principal explanation of overissue. It was claimed in the prospectuses that the earnings of the constituent companies before the consolidations were sufficient to pay dividends on the preferred, and there is no reason to doubt that these statements of fact were true. The plants no doubt did earn enough for a respectable dividend, and the preferred stock did, in most cases, represent the earning power of the companies before consolidation. Some juggling with figures there no doubt was, and an exaggeration of earnings was often the result, but it is difficult to believe that reputable accountants, such, for example, as

¹ Jenks, "The Trust Problem," p. 105.

Mr. Stephen Little, whose reputations depend upon their accuracy, would sell themselves to any wholesale tampering with figures. It is of course conceivable that the accountants made false statements sufficient to seriously injure the investor in trust stocks, but it is by no means probable. Nor were the conditions upon which the payment of common dividends depended, obscure or hard to understand. The common stock represented the capitalized value of the economies of combination and all agreed that they would be great. All the savings in management, shipping, buying and selling, besides the gain from the greater control over prices, were to go to the common stock. Where then was the secrecy? Indeed, by the same writers who so severely reprehend the "secrecy" of the trusts as being the cause of the inflated value at which their common stock has been sold, it is argued that the trust movement is a distinct advance in industrial organization and that its economies are very considerable. They admit then that economies do exist, and it is certainly reasonable on their own statements to explain a part of the inflated value of the common stock by reference to an exaggerated estimate on the part of the public of the value of these economies and not entirely to the hole and corner activity of the promoters. The promoters were making claims about the future and the truth or falsity of their claims only the future could reveal. How is it possible to make the future plain to the present? The only way to guard against such miscalculations would be to prosecute on a criminal charge any promoter whose predictions were not borne out by the event, and this would be to abolish the promoter entirely. If he is not to use his imagination his occupation will be gone. If the community desires men to take large risks and run long chances—the essential condition of rapid progress by the investment of capital in new and untried fields—then the periodical waste of the savings of the people in wildcat schemes follows as a matter of course. The conservative investor, who is able accurately to estimate the value of a

proposition, will not take chances, and the speculative investor, who is ignorant and susceptible, will, on his part, also decline to invest his money unless he is promised a rate of return which, by its very amount, shows the great risk which it involves. Without the promoter and his eloquent and persuasive representations, speculative investment would cease and industrial advances would only be made when the profit was certain beyond the peradventure of a doubt. We prefer the jack-rabbit style of progress, and we must accept its consequences.

The buyer of industrial common stock has been sacrificed on the altar of a new form of industrial organization. If a permanent advance has really been made the gain to society may outweigh the loss to individuals. It is certain, however, that the trusts could not have been financed within such a short time and in such large numbers without the common stock, and also that the common stock would not have been sold without the misrepresentations which were made concerning its ultimate value. If the movement had proceeded slowly, legitimate investment might have sustained it, and conservatism of statement might have prevailed. But in the United States we do not do things little by little. We do them all at once, and a reorganization of the greater number of manufacturing industries of the country within two years could not be accomplished without prodigious waste and stupendous lying. It is not publicity which will cure the evil of overcapitalization, if evil it be called, but a new ideal of industrial progress based upon investment instead of speculation, and the realization of such an ideal implies a reconstruction of human nature. Until imagination is destroyed, emotional susceptibility deadened, and clear judgment seated firmly on the throne of the common mind, we shall probably experience again and again these waves of speculative excitement, and the capital for new and risky enterprises will continue to be perennially drawn from the pockets of the eternally gullible.

The losses of the underwriter.—There is one feature of the situation, however, which should afford much amusement if not consolation to those who have suffered loss from purchasing industrial common stock, and that is the fact that the eminent and respectable underwriter who had planned to work off his large holdings on his credulous countrymen has for once overreached himself. He also has been caught in the toils. The trust movement was quickly overdone. Seven thousand millions of shares within two years was too great for the speculative appetite. It was impossible to find purchasers for the shares issued even had they offered a secure investment. This was not foreseen by the underwriters, who were even more eager to mulct the public than the public were to give them the opportunity. The underwriters were, therefore, compelled to buy shares for which they could find no market. The following extended quotation from the "Investor" so exactly describes the situation and the event has so fully verified its predictions that I venture to give it in full:

"We have tried on a number of occasions to show that the promoters and underwriters must inevitably meet with great loss. Very few persons, however, have yet begun to realize the extent of these losses. For this reason we are disposed to quote the following from some recent utterances of a well-known bear operator in New York. He may have an 'axe to grind' in talking thus, but that does not alter the facts. He says: 'Few people know how serious have been the losses to individuals and firms in and out of Wall street by too extended underwritings of the issues of new industrial combinations lately exploited. It is well known that with the exception of the first few issues the bulk of the flotations since have been failures, bringing with such failures widespread losses to underwriters and institutions. The stocks of the new combinations, or most of them, are absolutely unsalable, and, of course, valueless as collateral. The underwriter who has paid to the institution financing the new trust the amount of his underwriting commitment to it, is crippled by the amount so paid, for he receives securities in return which he cannot borrow on or sell except at a frightful loss. If he has failed to respond to the financial institution's call for his guarantee to it, then he makes that institution

carry his load, and that institution depends upon the public for its deposits. When one considers that in this city alone it is conservatively computed that these underwriting commitments amount to hundreds of millions of dollars, with underwritings for millions in Philadelphia, Boston, Baltimore and Chicago, the tremendous strain of the situation is revealed.' The above is the only rational view to take of the situation. The losses to the parties who have promoted and underwritten the industrial trusts that have been started since January, 1899, will turn out to be so great that it will be only by the exercise of the greatest skill on the part of those having in charge the financial interests of the country that the trouble does not become widespread, and include the innocent as well as the guilty. We shall be glad if the increasing prosperity of the country does not receive a tremendous setback from the losses which are bound to overtake the individuals who have endeavored to palm off on their countrymen several billions of dollars in bogus securities." ¹

The troubles of the Amalgamated Copper Company offer a concrete illustration of the general account and show the great difficulty experienced in carrying industrial shares. In this case the promoters had themselves taken the underwriting.

"This trust was formed of a number of companies, the Anaconda being the largest. Anaconda had been advanced to a very high figure at which it was turned into the Amalgamated; namely, to the Standard Oil crowd. About three-eighths of the stock, however, was held in England and was not at once turned in. The Amalgamated people now proposed to put their stock up to 150 or 200, but just at this time the English holders of Anaconda decided that they were satisfied to sell and began to unload their holdings at higher figures than they had thought possible a year before. Besides this they were naturally suspicious of the bold and energetic men at the head of the Amalgamated. The promoters of Amalgamated had to take and carry all this stock. If they had not done so there would have been a sharp break in the market and Amalgamated would have been pronounced a failure at the start. This was a heavy strain upon the promoters, which was greatly increased when England began to sell copper for future delivery, believing that it had reached the highest price. The Amalgamated had to take all the copper offered. The task was most difficult, even for the Standard Oil interests with the

¹ "United States Investor," October 21, 1899.

support of their own banks and trust companies, and it was reported that they were forced to sell \$20,000,000 of gilt edged securities in the open market to obtain cash for margins."¹

The condition of the industrial market during the fall of 1899 may be shown by another quotation from the "Investor."

"This has been another bad week for the coppers, and the market has presented an even more demoralized appearance than it did last week. There is scarcely any support, and the least pressure to sell causes prices to recede. A considerable amount of long stock has been unloaded by tired and disgusted holders, and the market has continued to sag until it has reached the lowest level seen this year. A feeling of uneasiness lest the price may break badly at any time, has evidently seized a good many stockholders in the coppers, and, frightened at the outlook, they have hastened to get out. It does not tend to increase their confidence, to see the prices of the shares in which the Standard Oil magnates are interested decline as pronouncedly as the others. They are beginning to realize that they have been misled, deceived, hoodwinked, that their credulity has been played upon."²

These "tired and disgusted holders" were mainly the speculators who were tired and disgusted with repeated calls for margins. Many of these have paid for the stock outright and now hold it for an investment. Others are still being carried by the brokers.

These quotations refer to the condition of the underwriters in October, 1899. It is not often that such pessimistic predictions have so speedy a fulfillment. The panic of December, 1899, was an "underwriters' panic" and is so remembered. It was brought on by the very cause which has been here indicated. The underwriters were loaded up with unsalable securities, and, when interest rates went up, they could no longer bear the strain. In order to save themselves they threw overboard large blocks of stock, both bad and good, the innocent indeed suffering in the heavy decline

¹ "United States Investor," September 2, 1899. (Abstract.)

² "United States Investor," October 28, 1899.

along with the guilty. The two most important failures, those of the Produce Exchange Company, of New York, and the Globe National Bank, of Boston, were directly due to loans made on trust stocks, the first mentioned mainly on United States Flour Milling, and the second on Copper. The stock market has not yet recovered from the effects of the underwriters' panic which frightened the speculator away from the game. In this effect it resembled a police raid upon a gambling house. Legitimate investment has also suffered from the overspeculation in industrials. Such a panic, however, may be expected after every period of inflation. It is one of the penalties of progress.

VI. *Preferred stock in its relations to common stock:* The common stock, it is safe to say, will in the great majority of cases, be almost obliterated. In this it differs from the stock of most speculative enterprises, some of which are always likely to succeed. Hardly any of the trust common stock, however, can be expected, for a long time to come, to pay large dividends, and it will be fortunate even to escape the expurgating process of reorganization. The reason is that large amounts of preferred stock have been placed before the common to soak up and absorb all the fortuitous gains which might possibly come to the junior security. The wording of one of the charters in regard to preferred stock will introduce a description of the method by which it is possible to altogether destroy the interest of the unlucky holder of common stock. The extract is taken from the charter of the American Steel and Wire Company of New Jersey, and is typical of similar provisions in other charters :

"The holders of preferred stock shall be entitled to receive in each year out of the surplus net profits of the corporation a fixed yearly dividend of seven per centum, payable quarterly before any dividend shall be set apart or paid to the common stock, but shall not be entitled to any further dividend or share of profits. The dividends upon the preferred stock shall be cumulative, so that if in any year divi-

¹ "United States Investor" October 28, 1899.

dends amounting to seven per cent per annum are not paid on the preferred stock, the deficiency is payable subsequently before any dividends are set apart or paid on the common stock. In case of liquidation or dissolution of the corporation, the holders of preferred stock will be entitled to be paid in full, both the principal of their shares and the accrued interest charge, before any amount is paid to the holders of common stock; but after the payment of any such liquidation or dissolution to the holders of the common stock of its par value, the remaining assets shall be divided equally among the holders of both classes of capital stock.”¹

Nearly every trust issues preferred stock, and out of one hundred and two issues during the first six months of 1899, all but sixteen had the cumulative feature. It is this cumulative feature which renders the case of the common stock holder altogether hopeless. Not only is the preferred stock holder insured a high rate of return before anything is paid on the common stock, but if, for any reason, his preferred dividends should not be earned, they accumulate to his credit and constitute a claim against the company, which must be paid when prosperity returns, before the common stock holder gets a penny of return. This amounts to saying that, after the first season of depression, the common stock holder will get nothing at all, for it is hardly reasonable to expect a seven per cent rate of net earnings from the majority of the trusts year in and year out. Some bad years must be experienced by every industry, and with but one issue of stock the losses of depression would be offset by the higher gains of prosperity. Not so, however, when common stock is yoked with cumulative preferred. Then there is no hope for the common stock holder. All extra earnings must be devoted to paying up overdue claims of the preferred. It is only necessary to refer to United States Leather with unpaid preferred dividends of 31 per cent, Tennessee Coal and Iron, 40 per cent, and Colorado Fuel and Iron, 28 per cent, to show the significance of this cumulative provision.

¹ "Commercial and Financial Chronicle," vol. 68, p. 377.

The issue of cumulative preferred stock is no longer recognized as good finance. Very few issues of railway preferred stock contain this provision. Not only this, but even preferred stock, which is non-cumulative in the great majority of cases, has only been issued in reorganizations, where it is substituted for bonds, being only one grade inferior to them but releasing the road from fixed charges. In original issues of railway stock it is very unusual to find the preferred feature. It was formerly employed in reorganizations, but it is so manifestly incompatible with the maintenance of any value in the common stock that it has been by general consent abandoned. Its recrudescence in the industrial charters was due to the haste and fury with which the movement toward consolidation was carried through. It was necessary for the promoter to take the manufacturers by storm, and to this end the cumulative feature was offered as an assurance that they would be perfectly secure in entering the trust. The common stockholder was to take all the risk. Publicity, it will be observed, will not improve this situation. Nothing is more public than Cumulative Preferred.

Diversion of earnings from common stock.—But there are other methods available to divert earnings from common stock to the benefit of preferred. Corporation dividends are payable only when, “in the judgment of the directors,” they have been earned. If the directors happen to represent the preferred stock,—and this, be it noted, is the general situation, preferred stockholders, that is to say, the original owners of the constituent plants having generally retained or purchased enough common stock to give them a majority,—in such a situation, it is only necessary for the directors to decide that the interests of the company require a larger “working capital” or additional “capital expenditure,” or a “larger surplus” to appropriate to the purpose of strengthening their own holdings all the gains of exceptional prosperity which would naturally go to the common. This is the

usual method where large dividends on the common have in some cases been earned. We should acquit the managers of any sinister designs on the common stock as stock. Their antagonism is only towards the holders thereof. If they were perfectly certain that the preferred dividends would be earned, and that something would always remain for the common, they would retain the common or buy it in after depressing its value. But there is no such assurance. The time of adversity threatens, when competition must be met and low prices endured. The preferred stockholders, therefore, set to work to strengthen their position, and to make their dividends more secure by diverting, to their own use, through a perfectly legal and public channel, the surplus earnings. Every dollar which they can put into permanent improvements, new machinery, stores of raw material, or the purchase of competition, is so much gained for the preferred stock. It adds greater strength to the company and insures a higher average of earnings. The methods of the International Paper Company illustrate this practice. This company was organized with twenty-five millions of preferred stock and twenty millions of common. It included seventeen plants which manufactured, according to its own statement, practically all the newspaper consumed east of Chicago. A dividend of one-fourth per cent on the common stock was declared in November, 1898, and all went well with the company until February 4, 1899, when it was announced that there had been acquired fourteen additional pulp and paper manufacturing concerns which had been competing with it. To acquire these concerns some cash had to be expended and additional securities were issued. Some \$60,000 or .3 of 1 per cent was paid on the common stock, which immediately fell from 65 in January to 40 in June. On August 5 President Chisholm, in response to an inquiry of an anxious holder of common stock as to the prospect of his ever getting anything from his investment, stated publicly that "the condition of the company is ex-

tremely satisfactory. Its profits are large and its future assured." This was extremely gratifying and International Paper went up $3\frac{1}{2}$ points. But the hopes of the common stockholders were doomed to disappointment. At the annual meeting on September 2d the announcement was made that the company had made a large expenditure for improvements on new mills, etc., and was now engaged in building a factory with an output of 10,000,000 paper bags. During the year the company had established a number of agencies abroad and had had no difficulty in disposing of its entire output. The dividends amounted to \$1,786,206, of which \$1,500,000 went to the preferred stock, 6 per cent and \$286,000 or 1.4 per cent to the common stock. The statement was very satisfactory to everybody except the common stockholder. International Paper common immediately fell to 31 and by November, 1899, it was down to 25, and now stands at 19.¹

Another method of converting earnings could be pursued by the managers which would involve the destruction of the company for their own benefit. This would be to incur a floating debt for working expenses, to pay dividends which had not been earned, and by thus raising the value unload the stock upon the unthinking investor, who would then pass through the ordeal of a reorganization for the benefit of the creditors. This was actually done in the case of the National Cordage, in 1893, and some of the recent difficulties of American Malting arouse suspicions of a similar attempt to wreck this company.² Financial opinion, however, which it is not wise in this day to brave, so strongly condemns this revival of the piratical methods of Fiske and Gould that actual wrecking will be rare. Some of the enterprises of

¹ "Commercial and Financial Chronicle," September 16, 1899. A director thus explained the passing of a common stock dividend: "We are realizing greater profits than ever before in our history, but we felt that the money earned could be better used for improvements and the like and hence our action."

² "Commercial and Financial Chronicle," March 10, 1900. The directors had incurred a floating debt of \$3,000,000, mainly for "working expenses."

Mr. Thomas MacIntyre, who fathered Brooklyn Wharf and Warehouse and United States Flour Milling, have, however, been open to the suspicion of wrecking methods. The following extract from the affidavit of Mrs. Ora M. Jewell, in her suit to compel the restoration of the shares of Hecker, Jones and Newell, which she had deposited with Mr. MacIntyre in exchange for an interest in the United States Flour Milling Company, reveals with some distinctness the opinion of an insider in regard to the methods of this promoter:

“Deponent is informed and believes that said MacIntyre interested himself in the plan for the purpose of abstracting from the company to be formed the promoter’s proceeds, without regard to the original holders of the stocks and bonds and the new purchasers thereof. That said MacIntyre tried to induce various mills to go into the scheme according to the agreement of August 22, viz., the Washburn-Pillsbury and the Washburn-Crosby Mills, and failing to induce them to go into it, that he determined, nevertheless, to push through the scheme and not to lose his ill-gotten gains.

“That said MacIntyre was one of the parties behind the circular or prospectus of May 13, 1899. . . . That said prospectus contains misstatements, misrepresentations and evasions, and that said MacIntyre became the treasurer of the new company, and has finally succeeded in wrecking it so that it is now in the hands of a receiver admittedly insolvent, and that said MacIntyre is now seeking through a reorganization agreement to perpetuate his control and methods, and that finally, if the relief prayed for by this plaintiff be not granted, the reorganization agreement may become operative and the plaintiff’s securities still further removed from her control.”

Such cases as these—and the promoter was here apparently guilty of the grossest misrepresentation—are abnormal and do not afford a safe guide to the future policy of the trusts. It is all well enough to fleece the public, that is expected, but violation of financial ethics “between friends” is now generally condemned, and, as Mr. MacLeod discovered in 1893 when ousted from the receivership of the Reading Railway Company, is often visited with condign punishment.

Future stability of the industrials—The preferred stock of the trusts is reasonably certain to survive, although it will have been perpetuated at dreary cost to the unlucky holder of common. At the present time indeed preferred industrials bear a low value, much lower than the value of railway stocks. This is shown by the following table, which contrasts the value on July 13, 1900, of leading issues of preferred industrials whose dividends have been fully paid, with the value of railroad stocks whose return is as large in some cases, but whose security is absolute:

Industrials.	Rate of One Dividend, 1899.	Value.
American Car and Foundry	7	64½
American Ice	6	65
American Linseed Oil	7	53¾
American Smelting and Refining	7	88 1-16
American Steel and Wire	7	72 1-16
American Steel Hoop	7	68½
American Tin Plate	7	75
Continental Tobacco	7	25½
Federal Steel	6	65¾
International Paper	6	65
National Steel	7	84½
National Tube	7	90 1-16
Republic Iron and Steel	7	54
United States Leather	7	68½
United States Rubber	8	90½
Railroads.	Rate of Dividend, 1899.	Value.
Chicago, Burlington & Quincy	6	124¾
Chicago, Milwaukee & St. Paul (Pref.)	7	170½
Chicago & Northwestern (Pref.)	7	197
Chicago, Rock Island & Pacific	5	106½
Great Northern (Pref.)	7	152¾
Illinois Central	5	117¾
Lake Shore & Michigan Southern	7	210
Louisville & Nashville	3½	73 3-16
Michigan Central	—	106
New York Central	4	130 1-16
New York, New Haven & Hartford	8	212
Pennsylvania	5	128

The railroad stocks are investment securities. Their high value is due to the fact that they are strongly held and eagerly sought for, while only a small amount comes into the market. The industrials, on the other hand, owing to the uncertainty which clouds their future, especially the fear of hostile legislation, are loosely held and sold in large amounts on every advance. This condition will probably soon pass away. There is no reason to expect any drastic legislation against the trusts. Just at this time people are stirred up against them, but the business interests of the United States are too deeply concerned in their maintenance, and their securities are too widely held, for this agitation ever seriously to threaten their existence. After all, the higher average price which great companies can exact, is a small burden compared with the greater stability and constancy which they introduce into industry, and the check which they impose upon speculative construction in the lines of industry which they dominate. It should not be forgotten that the panic of 1873 was due to the construction of railroads with borrowed money, and the panic of 1893 was caused, in large part, by speculative construction of manufacturing plants on the same basis. It will not be so easy in the future to borrow money to compete with \$100,000,000 of capital. As for the trusts themselves, just as the railroads have come to do, they will probably adopt the safe and conservative policy of making improvements out of net earnings and refusing, unless it plainly results in an increase of productive power, to incur debt when debt can be avoided.

It should not be forgotten, in this connection, that the trusts have no debts to speak of, and that they therefore start with a great advantage. The fact of their small indebtedness has already been set forth. The common stock buyer at heavy cost to himself, has performed a most valuable service for the community in that he has paid off the mortgages on most of the plants, and has placed them in a position

where, with ordinary caution, they are safe from bankruptcy. A man who is out of debt cannot become a bankrupt. This again inclines to the opinion that the trusts will powerfully contribute to insure the financial stability of American industry.

At present, it must be admitted, they contain a great deal of dead material,—antiquated machinery and worn-out plants, purchased perhaps at an excessive value. These will be weeded out, as they would have been, only more quickly, under the old system of competition. This done, there will remain a number of strong companies, which will exercise the same wholesome control over manufacturing industry that the railroads do over the business of transportation. Their securities will offer as safe investment as any now held by the savings banks. With increasing stability of value and the growth of a settled investment interest in their securities, greater frankness will characterize their reports. The railroads themselves have been a long time in learning that frankness is the wise policy, and the trusts may be expected, in the same way, to enlarge their annual reports, and to publish weekly and monthly statements of net earnings. So long as the stocks are wanted for speculation, however, secrecy of management will be the rule, and it would be unkind to the margin speculators to do them good “whether they will or not” by settling the value of the shares with which they wish to gamble, and so confiscating, as it were, the tools of the trade. It may indeed happen that competition will arise and that competitors may have to be bought or crushed out; but this necessity is only a slight cloud in the sky of promise.

One measure only is necessary before the conditions of stability can be secured. The common stock capitalization must be reduced. Its low value is a constant menace to the financial stability of the industrials. There is danger lest some enterprising financier may buy up enough stock to give him a majority in the board of directors. He might then proceed

to use up the surplus in paying dividends on the common stock; incur floating debt if necessary; run the stock up to a high value, and sell out, leaving the company to the creditors and the receiver. This was done repeatedly in the case of the stock of reorganized railroads before the voting trust was devised to secure the stock until the payment of dividends should so raise its value, that it could be released without danger to the property. The trusts are just now in the same condition. The low priced stock is a constant temptation to the wrecker, and the capitalization must be reduced or in some way protected. The voting trust has been suggested. The common stock of the Distilling Company of America has been placed in such control, "in order to solidify the different interests and to insure conservative management," but a safer plan will be to reduce the common stock. By no possibility can dividends be paid upon its present amount, and a voting trust is only warranted when the early payment of dividends may be expected. It is not intended by instituting a voting trust to hold the stock in perpetual duration. A movement has already begun in this direction of reducing the capitalization. The directors of the Distilling Company of America have recommended the cancellation of unissued common and preferred stock to the amount of \$20,000,000. American Smelting and Refining has reduced the preferred to a similar amount. American Steel and Wire has placed its common stock on a 7 per cent basis. It will probably not be difficult to arrange for these reductions. Common stockholders, many of them, have purchased on the decline and a reduction of 50 per cent in the holdings, provided that dividends were paid on what remained, would still give them a good return on the actual investment. Then with the removal of the cumulative feature from the preferred and the assurance of legal security to the companies, the industrials will be firmly placed upon an investment basis. By that time, however, colonial enterprises will be ready for sale, and the

speculative investor will once more be called upon to bear the burden of another industrial advance, by turning over his savings, without much prospect of return, to the same men who have repeatedly mishandled him in the past.

EDWARD SHERWOOD MEADE.

University of Pennsylvania.